PENSION MANAGEMENT OVERSIGHT COMMISSION

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MEETING MINUTES[1]

Meeting Date:	**September 29, 2005**
Meeting Time:	**10:00 A.M.**
Meeting Place:	**State House, 200 W. Washington St., Room 431**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**2**

Members Present: **Sen. Joseph Harrison, Chairperson; Sen. R. Michael Young; Sen. Allie Craycraft; Rep. Larry Buell; Rep. Woody Burton; Steve Meno; Kip White.**

Members Absent: **Sen. Larry Lutz; Rep. Thomas Kromkowski; Rep. R. Tiny Adams.**

Senator Joseph Harrison, chair of the Pension Management Oversight Commission (the Commission), called the meeting to order at 10:15 a.m.

1. Discussion of Preliminary Draft 3085 Concerning Pension Relief Fund Distributions

Staff explained that Preliminary Draft 3085 (Exhibit 1) would amend IC 5-10.3-11-4.7 to eliminate the January 1, 2008, expiration date for the additional distributions from the Pension Relief Fund that ensure that at least 50% of the pension liability of each unit of

[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.ai.org/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

local government is paid from the Pension Relief Fund.

Doug Todd of McCready & Keene, the actuaries for the police and fire pension funds, summarized the history of the Pension Relief Fund. The Pension Relief Fund was created in 1977 to help cities and towns meet their police and fire pension obligations. Cities and towns are paying current benefits for police officers and firefighters in the 1925 Police Pension Fund, the 1937 Firefighters' Pension Fund, and the 1953 Police Pension Fund (collectively, the Old Funds) while simultaneously funding benefits in advance for 1977 Police Officers' and Firefighters' Pension and Disability Fund (the 1977 Fund).

The major sources of revenue for the Pension Relief Fund include a dedicated portion of cigarette and liquor taxes that totals between $30 and $40 million each year, lottery revenues of approximately $32 million each year, and annual investment income of $15 to $20 million at an assumed interest rate of six percent per year.

Mr. Todd briefly reviewed the "K" and "M" formulas for determining distributions from the Pension Relief Fund. The "K" formula determines the amount by which distributions to cities and towns from the Pension Relief Fund may increase each year so that the Pension Relief Fund will distribute its last dollar as the benefits paid under the Old Funds peak. The "M" formula supplements the "K" formula and adjusts a unit's distribution by taking into account not only a unit's increases in pension outlays because of the Old Funds and converted member benefits, but also a unit's increases in outlays as a result of contributions to the 1977 Fund.

Mr. Todd then reviewed a set of charts showing the Pension Relief Fund's likely performance under various scenarios (Exhibit 2). Under current law, the present value, as of July 1, 2005, of the "Gray Area" (the shortfall of relief due to the exhaustion of the Pension Relief Fund) is $177.3 million, and the shortfall will begin in 2013. If the 2007 sunset of the 50% guarantee is repealed as proposed in Preliminary Draft 3085, the present value of the "Gray Area" as of July 1, 2005, increases to $520.7 million, and the shortfall will begin in 2012. If the sunset of the 50% guarantee is not repealed, but instead is extended through 2012, the present value of the "Gray Area" as of July 1, 2005, is $203.5 million, and the shortfall will begin in 2012. All scenarios assume an annual rate of return for the Pension Relief Fund of seven percent.

Mr. Todd then presented a second set of charts that illustrates the effect of the sunset of the 50% guarantee on selected cities and towns (Exhibit 3). He directed the Commission members' attention to the difference between the 2007 and the 2008 Pension Relief Fund distributions, if the sunset occurs, and the effect of the difference on a unit's outlay for pension benefits. For example, the City of Attica would have a decrease of $8,085 in its 2008 Pension Relief Fund distribution and a $9,039 increase in the city's 2008 outlay for pension benefits, if the sunset occurs. On the other hand, the City of Indianapolis will have an increase of $1,154,000 in its 2008 Pension Relief Fund distribution as well as a $1,007,000 increase in the city's 2008 outlay for pension benefits, if the sunset occurs. The difference in the amount of the Pension Relief Fund distributions between these cities is the result of differences in the population and the maximum tax levy.

In response to a question from Senator Young, Mr. Todd stated that there are currently approximately 10,000 retirees statewide in the Old Funds.

Matt Brase representing the Indiana Association of Cities and Towns (IACT) testified in support of Preliminary Draft 3085.

The Commission by a unanimous vote recommended Preliminary Draft 3085 for introduction in the 2006 session of the General Assembly.

2. Discussion of Preliminary Draft 3086 Concerning the Public Safety Deferred Retirement Option Plan (DROP)

Staff explained that Preliminary Draft 3086 (Exhibit 4) would repeal IC 36-8-8.5-1, the December 31, 2007, expiration date for the public safety deferred retirement option plan (DROP).

Mr. Todd briefly explained how a DROP works. He presented charts projecting benefits under a continuation of the DROP and no change in retirement patterns for both the 1977 Fund and the Old Funds (Exhibit 5). He pointed out that it is actuarially neutral to continue the DROP for members of the 1977 Fund. The 1977 Fund saves money when a member enters the DROP before the member completes 32 years of service.

For the Old Funds, the continuation of the DROP will result in an actuarial loss overall. However, there will be a gain in the short run if the DROP is extended. The DROP is an upfront cost to the Old Funds with a lower pension benefit afterwards. Mr. Todd estimated a $25.6 million impact to the Old Funds if the DROP continues.

In response to a question from Representative Buell, Mr. Todd said that the experience has been that six out of ten members eligible for the DROP elect the DROP. He started the chart for the Old Funds at age 61 (rather than 55), because the Old Funds are closed plans and that is the age of the youngest fund members.

Matt Brase of IACT supported the introduction of Preliminary Draft 3086 as it applies to the 1977 Fund because the cost is actuarially neutral. IACT's legislative committee has not yet decided whether to support the continuation of the DROP for the Old Funds.

Tom Miller representing the Indiana Association of Firefighters spoke in favor of continuing the DROP for both the Old Funds and the 1977 Fund. He estimated that there are 325 active members statewide in the Old Funds, the maximum number of people who could be eligible to participate in the DROP.

The Commission by a unanimous vote recommended Preliminary Draft 3086 for introduction in the 2006 session of the General Assembly.

3. Discussion of Preliminary Draft 3126 Concerning Public Employees' Retirement Fund (PERF) Administrative Issues

David Adams, PERF Executive Director, presented Preliminary Draft 3126 (Exhibit 6), which would: (1) amend IC 4-1-10-5 to authorize the release of an individual's Social Security number for the purpose of administering a state retirement fund or deferred compensation plan; (2) amend IC 36-8-8-12.7 and IC 36-8-8-13.1 to establish a review process by the PERF board for an impairment awarded under the 1977 Fund because a local pension board did not act in a timely manner; and (3) extend the pilot program for the legislators' defined contribution plan until July 1, 2007. Mr. Adams said that these proposed changes would not have a fiscal impact.

The Commission by a unanimous vote recommended Preliminary Draft 3126 for introduction in the 2006 session of the General Assembly.

4. Discussion of Preliminary Draft 3101 Concerning Teachers' Retirement Fund (TRF) Administrative Issues

Tom Davidson, TRF's General Counsel, explained the provisions of Preliminary Draft 3101 (Exhibit 7), which would: (1) amend IC 5-10.2-3-8 to specify the type of disability benefit that a TRF member must be eligible to receive in order for the member's surviving spouse to qualify for a survivors' benefit; (2) add IC 5-10.2-4-8.4 to allow a TRF member who also serves in an elected position and elects, while holding the elected position, to begin receiving the retirement benefits to which the member is entitled by age and service to choose whether to retire from TRF or PERF; and (3) amend IC 21-6.1-4-6.1 to restrict the award of military service credit by TRF to service that is not used by the member under the terms of a military or another governmental retirement plan. Mr. Davidson added that the Preliminary Draft would not have a fiscal impact.

In response to a question from Representative Burton, Mr. Davidson explained that the situation addressed in the Preliminary Draft is different from a TRF retiree who takes a new job covered by PERF after the person's retirement. In the second situation, the reemployment provisions of PERF will control. The reemployment provisions do not address the situation that is covered by the Preliminary Draft. The difference in the way service credit accrues (or does not accrue) in the two situations is the result of an IRS requirement that a member establish a retirement date before the member starts receiving a retirement benefit.

The Commission by a unanimous vote recommended Preliminary Draft 3101 for introduction in the 2006 session of the General Assembly.

5. Discussion of Preliminary Draft 3125 Concerning the TRF Executive Director

Commission Member Meno presented Preliminary Draft 3125 (Exhibit 8), which would amend IC 21-6.1-3-5 to: (1) eliminate the requirement that the TRF director be a member of TRF; and (2) require that the director be qualified by professional background and experience.

Senator Young asked how director candidates' qualifications would be determined. Senator Young expressed concerned that the Preliminary Draft as worded is too open ended and that a TRF member would never qualify to serve as the TRF director.

Commission Member White asked whether there might be a conflict between TRF members and an outside director.

Rod Ellcessor representing the Indiana State Teachers' Association (ISTA) explained that TRF employees are members of TRF, so that a person who was hired as the director would become a member of TRF. He also noted that TRF includes superintendents, school administrators, and principals, in addition to classroom teachers. He stated that ISTA supports a preference for hiring a TRF member as the fund's executive director.

The Commission requested that the Preliminary Draft be revised to allow the governor to appoint as the TRF director either a member of TRF or another person who is qualified by professional background and experience.

The Commission by a 6-1 vote recommended Preliminary Draft 3125, as revised, for introduction in the 2006 session of the General Assembly.

6. Discussion of Possible Statutory Changes Concerning Pension Bonding by Units of Local Government

Commission Member Meno presented several police and firefighter pension fund legislative issues for the Commission's consideration (Exhibit 9). He explained that, under current Indiana law, a city or town may issue taxable or possibly tax-exempt bonds to help fund the city or town's share of the benefit payment obligations under the Old Funds.

He outlined several problems with this approach. First, the amount of the bonds issued counts against the city or town's general obligation borrowing limit. Second, the investment options for the bond proceeds are limited by the public fund investment statutes that require that the proceeds be invested in securities with a maturity of less than a year. This restriction denies a city or town the higher interest earnings available for investments of greater than a year. Third, the bonds must be issued at a public bond sale. Because the issuance of pension bonds is somewhat complex, a negotiated sale would make the process easier and allow the sale to be completed at a lower cost to the city or town.

As a response to these problems, Commission Member Meno suggested three legislative changes. First, he proposed amending the statutes governing the investment of the bond proceeds so that a city or town would have the option to use PERF to invest the proceeds on the city or town's behalf until the proceeds are needed. Another alternative is to require a city or town to use the prudent man investment standard that currently applies to PERF and TRF when the city or town invests or reinvests pension bond proceeds.

The second proposal is to amend the statutes governing the issuance of pension bonds to authorize additional bonding capacity for cities and towns. Commission Member Meno suggested that this be accomplished using the same concept that the General Assembly recently authorized for school corporations. School corporations may issue pension bonds for up to two percent of the corporation's assessed value. The requirement that this amount be divided by three also has been eliminated. He explained that this change would triple the current bonding capacity of cities and towns, and that few cities and towns, except for Indianapolis, would be able to issue sufficient pension bonds without this change.

The third proposal is to amend the statutes governing the issuance of pension bonds to authorize cities and towns to issue the bonds using either a public bond sale or a negotiated bond sale. A negotiated bond sale would make the sale of the pension bonds easier and less costly.

Matt Brase representing IACT testified in support of the concepts presented. He stated that IACT is in favor of giving cities and towns as many tools as possible to allow them to pay their pension obligations.

Representative Buell questioned whether there were constitutional limitations on giving cities and towns more flexibility in the investment of pension bond proceeds. Staff was directed to investigate and report on this issue at the Commission's next meeting.

6. Other Business

Senator Young requested that a bill reducing the vesting period from ten to eight years for a participant in the Prosecuting Attorneys Retirement Fund be added to the agenda for the Commission's next meeting.

7. Next Meeting

Senator Harrison scheduled the Commission's next meeting on Thursday, October 20, 2005, at 10:00 a.m.

8. Adjournment

Senator Harrison adjourned the meeting at 11:25 a.m.